

Written Statement of the Alliance of Rural CMRS Carriers

Before the

Federal-State Joint Board on Universal Service

En Banc Hearing

July 31, 2003

Denver, Colorado

David LaFuria
Lukas Nace Gutierrez & Sachs, Chartered
1111 Nineteenth Street, N.W.
Twelfth Floor
Washington, DC 20036
202-857-3500
dlafuria@fcclaw.com

On behalf of the Alliance of Rural CMRS Carriers (“ARCC”), it is a privilege to have this opportunity to appear before the Joint Board.

Introduction

ARCC members are independent wireless companies who are focused almost exclusively in rural America. They face the same challenges and their circumstances are far more similar to rural wireline carriers than they are different. You will find these companies in rural areas of Colorado, Minnesota, Vermont, Maine, Wisconsin, Mississippi, Alaska, West Virginia, Virginia, Washington, Oregon, Nebraska and others.

This hearing is appropriate because challenges are complex, proposed solutions are diverse, and no single party has all of the answers. Above the complexity however, stands clear and simple direction from Congress, amplified by the Supreme Court and Federal Courts of Appeals, which must guide each decision taken.

Some commenting parties advocate a very narrow definition of universal service – that is – service to the home or business that delivers nothing more than the current wireline network. The position that one single wireline provides all the “access” that should be provided is contrary to the clearly articulated will of Congress.

Congress did not intend to limit rural consumers’ access to one service provider or one technology. Indeed, in 1996 roughly 95% of America already had that. In Section 254(b)(3) of the Act, Congress fundamentally changed the goals of universal service from simply providing access, to providing rural consumers with access *to the same kinds of telecommunications choices and at similar rates* available to those in urban areas.

Congress ordered that all markets be opened to competition, without exception. Open competition for support and customers will result in the most efficient provider or providers advancing universal service. The clear command from Congress and the courts is that the FCC must develop rules that drive the marketplace to deliver universal service and consumer choice. According to Congress, rules favoring one technology, or one class of carriers, must be rejected.

The Supreme Court has found the 1996 Act to be a deregulatory tool in search of competition, not a regulatory tool in search of regulation. The 5th Circuit has confirmed that universal service rules must have competitively neutral effects, support must be portable, and regulatory decisions are to focus on consumers. It ruled that regulating a marketplace outcome is anathema to the 1996 Act.

To those who argue that the current universal service policy induces artificial competition in areas where it would not otherwise be possible, we would ask two questions:

First, if you believe that wireless is a lower cost alternative, then what public policy principle supports the expenditure of scarce resources on higher cost, less efficient providers, in a manner that cements their inefficiencies?

Second, the statement that competition is artificial implies that the status quo is natural. Indeed, what is “natural” about the current state of affairs?

Attempts to frame this proceeding as being about controlling competitive ETC (“CETC”) entry and funding so as to sustain the federal fund must be rejected. The appropriate question must be:

How do we effectuate the will of Congress while providing for a sustainable universal service fund?

We offer the following suggestions:

1. Finish the Job of Removing All Implicit Subsidies from the Marketplace.

Congress commanded that all implicit subsidies be wrung out of the system and made explicit and available to competitors. This is a difficult political challenge because if it is properly done, the fund size must grow and eventually all Americans, especially those in urban areas, are exposed to the real costs of telephony in rural areas. No universal service debate can be had without a discussion of how to complete these tasks.

The FCC has begun this work, and in so doing the size of the fund has increased significantly – as expected. The explicit support mechanisms in the fund have replaced implicit subsidies that distort the market. But after seven years, the work is not done and it must be done if we are to ever achieve a system that is fair and sustainable.

Today the retail price of basic service in rural areas varies widely. Some pay close to \$40.00 per month, others pay \$5.00. Yet there is no apparent correlation between lower rates and higher telephone penetration. So the Joint Board should seriously consider whether sustainability of the fund requires rural consumers to pay for a larger share of their service.

One of the primary goals of the Joint Board and the FCC should be to recommit to finishing this vital work.

2. Manage the Fund With Long Term Objectives.

The FCC has attempted to manage the introduction of competition without severely shocking incumbents who today provide the bulk of service in rural areas. The RTF’s five year plan – to permit competitive entry while providing a safety net to incumbents in the form of the modified embedded cost methodology and no caps on support – is entirely appropriate.

But after several years, few CETCs have been designated and with some notable exceptions discussed below, the vast majority have only begun to receive support. Because it takes more than a few months to plan, purchase equipment, obtain rights of way, and market new services,

there is today limited evidence as to the competitive benefits that are being delivered through the introduction of competition.

Despite the fact that CETCs today receive a small fraction of the total available high-cost support, there has been a groundswell of criticism from incumbent interests that CETC entry is causing the increase in the fund size and threatens it long term. Numerous commenters have exposed these charges as untrue. The vast majority of growth in the high-cost support mechanism has come from (1) expected increases as a result of making implicit subsidies explicit as required by law, (2) increases to the schools and libraries fund, and (3) increases to the rural ILECs as a result of the 14th Report and Order, which will total over \$1.26 billion over five years.

As Mr. Wood aptly points out in his testimony attached to ARCC's comments, if you seek to introduce competition while protecting the incumbent from shock, short term the fund is going to increase. Long term, the fund can only be controlled by wringing out inefficiencies and making opportunities available for lower cost providers to enter.

Managing for the long term also requires hard examination of introducing an appropriate forward looking cost model for rural areas. It is now widely accepted that funding carriers on embedded costs is inefficient and wasteful. As long as carriers are funded on embedded costs, fund size will grow and all consumers will pay for inefficiency. The Commission has repeatedly stated its intent to move all carriers toward economic costs – that job must be finished.

To those who would say that forward-looking cost models cannot be deployed in rural areas because they are unique – and often have less than five persons per square mile – we respectfully point to the states of Mississippi and Arizona. In Mississippi, where the incumbent non-rural carrier, BellSouth, is subject to a forward looking model, there are many areas where the population density is less than five persons per square mile. It is about as rural as rural gets.

Yet the forward-looking cost model is working there and competitors are using available high-cost support to provide Mississippi consumers with universal service and increased choices. No party has introduced any evidence showing why a forward looking cost model that works in very rural Mississippi would not work in other rural areas of similar density, perhaps with modifications.

In Arizona, Smith Bagley, Inc. has entered a rural area with well below five persons per square mile and has added over 30,000 customers since commencing service as an ETC two years ago. It has invested far more than it has received in support. Despite its early and dramatic success, the incumbent has felt no effect because it is unaffected by SBI's entry.

Short term – SBI's entry has increased the fund size, but it has also significantly advanced universal service in that area.

Long term – as SBI's network penetrates these areas and increasingly provides a viable substitute for consumers, high-cost support must be made fully portable and based upon economic costs. When that happens, the market will decide whether there can be only one ETC, or more than

one. If the answer is one, then only the most efficient provider will be an ETC and the fund size will have been managed to the benefit of consumers in rural Arizona and everywhere else.

For some to advocate that we should declare today, by regulatory fiat, that any area will not benefit from competitive entry, thwarts the clear will of Congress and ignores objective facts. With support, wireless carriers can enter rural areas, can deliver choices, and may well be more efficient providers.

3. Dismiss Calls to “Go Back to the Original Intent of Universal Service”

Congress did not authorize competitive ETCs as a means of connecting up the last 5% of Americans who do not have telephone service. Indeed, some have observed that many people who did not have service, and still do not have service, have access to a telephone but they either choose or cannot afford to take service.

Calls to “go back” seek a universal service system that is pre-1996, where the fund is segregated for a single carrier and a for the most part, a single technology. We are past that. Congress has demanded that modern universal service not be limited to one connection to one fixed point.

Instead, we should be looking for ways to advance the goals that Congress has set before us – to advance universal service and competition based upon rules that have a competitively neutral effect. Universal service is the delivery of the nine supported services and any carrier that delivers those services should be eligible on an equal footing. It is **not** limited to delivery of the nine services to a geographic location such as a house or business.

One key is to put in place market incentives that drive participants to act both in their own best interest and in consumers’ interests. Fair competition for support and fair competition for customers – is vital to driving choice to rural consumers. When combined with accurately targeted support that is fully portable, it’s a key to the long term sustainability of the fund.

Most urban consumers today have access to high quality wireless networks, capable of providing one number to one person telephony, wherever they work, live or play. They also have reliable mobile 911 service that provides a level of health and safety unavailable in many rural areas.

In rural areas served by ARCC members, delivering some service at price points similar to those available in urban areas is not difficult. However, delivering the essential features described above throughout a service area, at a service quality level similar to that which is available in urban areas – at the same price points – is not possible without support. That is a fact which has been repeatedly recognized by the FCC, the Courts and state commissions.

Many commenters have properly quoted the FCC’s conclusion that provision of support to one carrier to the exclusion of others is a barrier to entry. No competitor could reasonably expect to enter the market for local exchange service in a rural area against a subsidized monopoly. In America, if it were possible, it would have happened sometime in the 20th century.

As the Supreme Court has pointed out, ILECs have an insuperable advantage, conferred by virtue of their monopoly hold on consumers, their control of local networks, and their exclusive receipt of high cost support. In most rural areas, it is the lock on rate of return-based support, along with the rural exemption, which combine with the other factors to form a complete barrier to entry. Without policies that encourage competitive entry, rural consumers will not see the benefits that Congress intended to confer.

4. Advancing Universal Service and Encouraging Competitive Entry are Twin Goals Which Can be Accomplished.

It took years to work through the process of developing rules that have brought us this far. Moving to the next level cannot be properly accomplished in one short comment cycle. However, there are several interim steps the Joint Board should take now to promote the above goals.

a. Cap Support in Study Areas Where Competitors Have Entered.

Caps on support to a study area, even soft ones that can be raised due to inflation or other factors, are essential to managing growth in the fund. It was recommended by the Joint Board years ago and the rationale for imposing it – to manage growth of the fund while encouraging competitive entry – remains valid. ARCC does not believe that competitors have had sufficient opportunity to drive infrastructure investment in most rural areas and thus caps should not be immediately imposed, however if that decision is taken in a competitively neutral fashion, ARCC members would support it.

b. Make Support Fully Portable

Hand in glove with caps is making support fully portable. Portability of support is viewed by some as an option. Not true. The Fifth Circuit's Alenco decision mandates portability. There can be no competitively neutral system of support without portability. Today, a competitor receives the per line support available to the incumbent, however the incumbent loses no support as a result. This has had the effect of stimulating competitive entry while protecting the incumbent from shock. At some point, however, in order to permit market forces to drive efficiencies and lower funding requirements, incumbents must face competition for both support and consumers. Otherwise the program will degenerate into corporate welfare for all.

c. Begin in Earnest the Process of Moving ILECs to Economic Costs.

CETCs are the tail on a very fat dog. Attempting to cut the size of the fund by limiting access to by competitors will produce no meaningful savings and will ensure the substantial expansion of the fund because ILECs will continue to receive inefficient support that has increased in billions over the past several years. That process is not simple. The political and institutional will to carry it out requires leadership and an acceptance by all that the will of Congress must be fulfilled.

d. Require ILECs to More Accurately Target Support Upon Competitive Entry

To date, less than ten percent of rural ILECs have disaggregated support. In many areas where competitors have entered, incumbents continue to receive support averaged across an entire study area. Thus, it is possible that competitors will receive uneconomic levels of support (even though competitors have no idea where incumbent costs are high or low).

More accurately targeting support to high-cost areas is essential to sustaining the fund. Competitors entering low cost areas should receive little or no support. States are perfectly capable of ensuring that incumbents enact lawful plans of disaggregation.

These four actions will go farther to advance universal service, promote competition, and lawfully fulfill Congressional mandates than any other plan of action proposed in this proceeding.

5. A Primary Line Restriction is Not Competitively Neutral and Will Waste Valuable and Scarce Resources.

Restricting support to one “primary” line per household or business unlawfully presumes that service to a physical point, whether that be a home or business. This violates clear Congressional direction that rural consumers are to have an opportunity to receive the same choices of services and the same prices as their urban cousins. The restriction to a house or business is not competitively or technologically neutral. Urban consumers have access to reasonably priced first lines *and* “second lines” and they have access to high quality universal service from wireless carriers. Rural consumers are entitled to comparable access.

Proponents of a primary line restriction seek anticompetitive and unlawful policy judgements, for example, that wireless services should be found to be “complimentary” to wireline service and therefore less deserving of support. Or that wireline service should be presumed to be primary because it was there first. Indeed exactly the opposite may be true. Many consumers – in rural areas and elsewhere – use their wireless phones as their primary phones, and consumers are placing an increasing proportion of their calls on their wireless phones.

As wireless/wireline competition continues to develop, the distinction between primary and second lines is blurred. Whether the wireline service is the second line and the wireless service is the primary line is unclear. So-called “second lines” whether provided by incumbents or new entrants, promote universal service and connectivity in rural areas.

There is no competitively neutral, administratively feasible means to distinguish between “primary” and “secondary” lines. A new term will have to be developed to complement slamming and cramming as carriers vie for consumer loyalty based upon support.

A perfectly valid objective – to ensure that the fund is sustainable – can be accomplished through competitively and technologically neutral means and regulators have an obligation to seek out those options first. We have set forth above four actions – caps on support, full portability, moving incumbents to economic costs, and disaggregating support – that can accomplish these goals in an entirely lawful, efficient, and neutral fashion if properly developed. We cannot

imagine why the Joint Board and the FCC would select an anti-competitive policy option such as primary line restrictions when it could accomplish precisely the same objective through a competitively neutral policy.

6. Paying Support to Competitors Based on Their Own Costs is Nothing Less Than Corporate Welfare for All.

Calls to pay support to competitors based on competitors' costs completely defeats the purpose of encouraging competition and driving down costs. It would cause virtually every competitive carrier to construct duplicate networks without regard to whether a business plan makes sense. It would cement in place the incumbent's inefficiencies and swell the fund without delivering to consumers any corresponding competitive benefits or efficiencies. Moreover, it punishes a lower cost provider by awarding higher levels of support to a provider that is less efficient. It is perhaps the worst idea proffered by any party.

The current 'per line' support methodology is a powerful driver of both competitive entry and efficient fund management. Competitors understand that there is a substantial likelihood that they will receive support if they invest, which the FCC found essential in its South Dakota Preemption Order. The better course is to fund all lines at the incumbent's economic cost and continue to examine incumbent costs every five years so as to drive down the support needed in a particular area. If a competitor eliminates the incumbent's monopoly hold on the local exchange market as a result of being a lower cost provider, consider providing support to an area based on the competitors' costs.

Conclusion

Market participants need some sense of regulatory stability in order to plan and invest. ARCC members moved forward based upon rules developed between 1996 and 2001 that culminated with a five year plan for rural areas. Many have now invested millions of dollars based upon a system that was carefully developed and with the understanding that changes would be made in 2006. The push to undo the current system by incumbents who have fought the current rules since their inception, must be rejected. We have proposed sensible and appropriate means of ensuring that universal service and competition are fostered in rural America and are already delivering the benefits that Congress has directed the FCC to provide.

Finally, we are constrained to note that **wireless consumers** are on a pace to contribute roughly \$1.75 billion per year to the high-cost fund. By law, wireless consumers in rural areas are entitled to the same choices of services as those in urban areas. Wireless carriers are today advancing universal service and developing networks that can compete as a low-cost provider of the supported services. The benefits in the areas of health, safety, economic development, and infrastructure and service improvements resulting from the introduction of competition cannot be understated. We urge the Joint Board to reject calls to return to the pre-1996 era and adopt competitively neutral rules that will encourage low-cost alternatives to enter all markets throughout the country.